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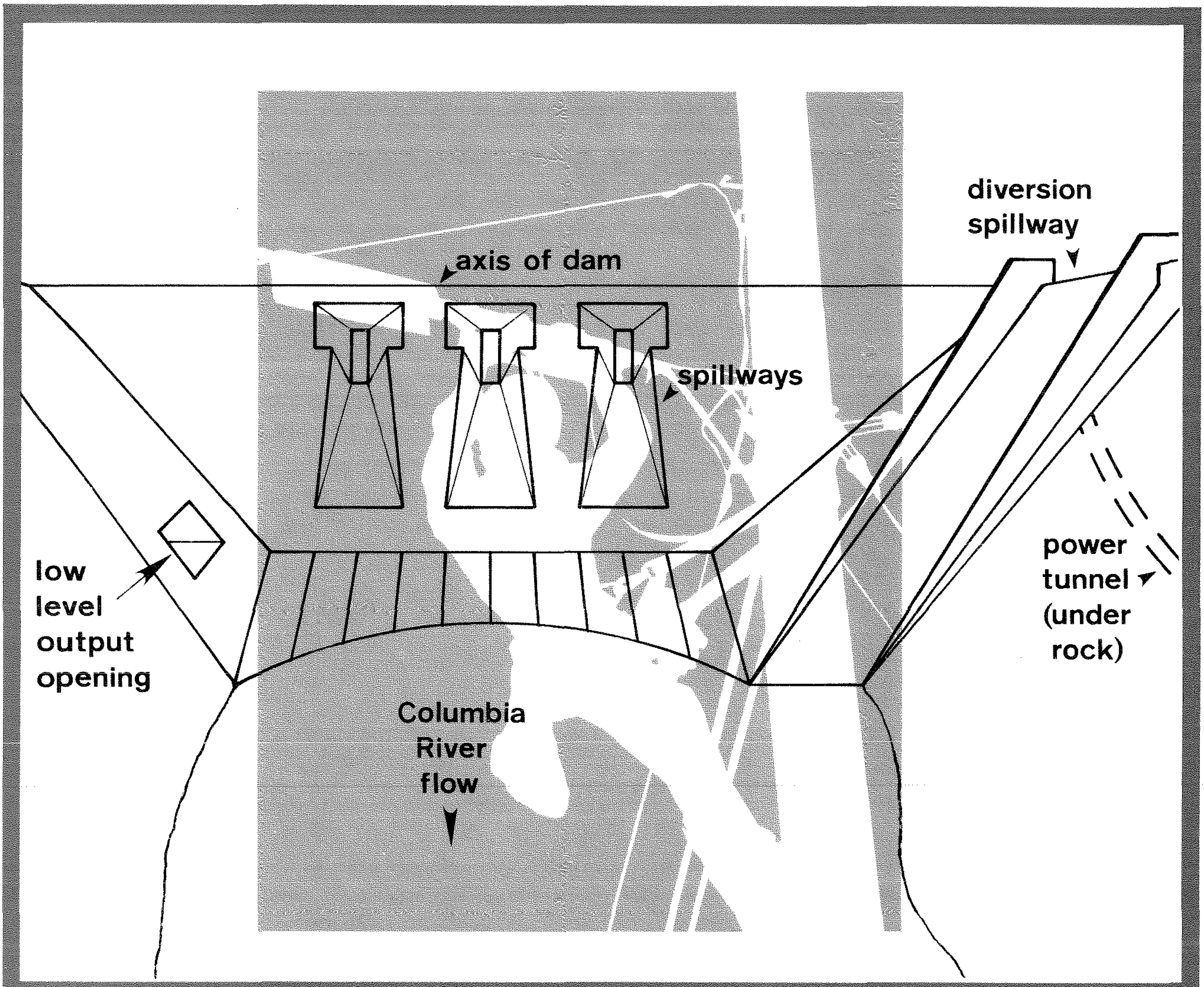

STUDIES IN LABOR MARKETS AND UTILITY PRICING

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In today's uncertain inflationary environment, when the state of macro-economic forecasting appears to be in a shambles, it's important to remember that economics can still generate powerful insights into the workings of individual markets. This can be seen from the answers to several policy questions posed in this issue of the *Economic Review*. Should "discouraged workers" be counted in the labor force and therefore in the official measure of unemployment? What role does family welfare assistance play in the high rate of unemployment among young workers? And in another field, should the pricing policies of Pacific Northwest utilities be changed to forestall future shortages of electrical power?

In response to the first question, Rose McElhattan notes that discouraged workers, by reporting that they are not looking for work, are by definition left uncounted in the labor force. But some analysts claim that they should be counted because they represent a labor-force reserve—that is, individuals who are willing and available for work when they are needed. McElhattan concludes, however, that they should continue to be excluded, because large numbers of discouraged workers remain so even during periods of tight labor markets, when substantial shortages of workers exist amid rising inflationary pressures. Moreover, discouraged workers represent only a small percentage of the cyclical movement in the labor force, so that their inclusion would mean very little correction of distortions in official labor-force measures.

McElhattan follows a "job search" approach in analyzing the phenomenon of discouragement for job-market reasons, which accounts for 70 or 80 percent of all discouraged workers. That approach suggests that the individual job seeker responds not only to the availability of jobs—conventionally considered the major determinant—but also to other factors affecting job-search decisions, such as unemployment-insurance benefit payments and expected short-run changes in real wage payments. Male workers appear to be sensitive only to changes in their unemployment rates, but female workers—who account for two-thirds of all those discouraged for job-market reasons—appear to be responsive to other factors as well.

The job-search approach also helps explain why the number of discouraged workers, contrary to common belief, does not decline substantially under high-employment conditions. (At full employment, the discouragement rate for job-market reasons actually tends to remain at about 85 percent of its average level.) Workers with relatively short work horizons generally find it profitable to limit the amount of job search, which is a costly undertaking. If not finding work within that relatively short time period, they may drop out of the labor force. "Many discouraged workers thus would expect to hold jobs, once found, for relatively short durations. Or workers may search the best-paying jobs first, and not finding employment, would choose to wait for normal job turnover—because that is the most profitable choice for them to make—rather than accept lower-paying jobs."

In a second study of labor-market problems, Randall Pozdena attempts to identify the origins of the high and growing rates of youth unemployment that the nation has experienced in recent years. (In 1978, teenagers alone were responsible for more than one-fourth of total

U.S. unemployment—and those under 25 accounted for roughly one-half of all jobless workers, but for less than one-third of the entire labor force.) Pozdena notes several studies which attribute youth unemployment to developments adversely affecting labor demand; for example, minimum-wage legislation, which tends to raise the cost of unskilled labor and thereby reduces the demand for such labor. But Pozdena also notes the importance of supply-side factors; for example, family welfare programs, which tend to reduce young people's willingness to accept or keep available jobs even though they continue to report an interest in finding work.

Analyzing the results of a controlled experiment involving welfare families in Seattle and Denver, Pozdena reaches the conclusion that youths tend to respond to welfare programs by reducing labor-market activity. "Thus, young people do not appear to be insulated from the work-retarding effects of welfare programs." Secondly, the results are consistent with the argument that family welfare support contributes to measured youth unemployment. Pozdena finds that the welfare experiment had the effect on youth of delaying their employment without delaying their entry into the labor force.

Most importantly, the study highlights the relevance of considering supply as well as demand factors. "There may be considerably more volition in the pattern of youth unemployment than is generally assumed. Although it is very difficult to determine precisely the effect of supply-side factors—such as attitudes, tastes, family structure, and family economic status—those factors may contribute significantly to the trends that have been observed in youth unemployment. Policy prescriptions thus can differ considerably, depending upon whether the problem has a demand-side or supply-side genesis. The results of this study suggest that a policy to eradicate youth unemployment by making jobs more available—through public-employment programs, for example—may not be completely successful in reducing unemployment among youths from welfare families."

Turning to another subject, Yvonne Levy warns of the danger of electric-power shortages in the Pacific Northwest during the 1980's, and adds that shortages are already a reality to aluminum producers and other major industrial customers in that area. Congress is now considering new institutional arrangements to balance demand and supply. "But by failing to address the fundamental cause of the disequilibrium—namely, the present inefficient pricing policies followed by the Bonneville Power Administration and other regional utilities—this Congressional approach is unlikely to provide a permanent solution to the region's electrical-supply problems." Bonneville's role is critical, because that agency is the wholesale supplier of over one-half of the total electricity consumed in the Pacific Northwest.

Levy argues that Bonneville should base its power rates not on average cost, but rather on long-run incremental cost. (The former is total cost divided by the number of units to be sold; the latter is the cost of producing additional electricity, taking into account the need to add more fixed factors, namely plant facilities.) "This pricing approach would result in a more efficient allocation of resources, because rates would reflect the true cost of the resources expended to provide consumers with each additional block of power. It would significantly lower the future demand for Bonneville power because its price would be much higher than under the current average-cost pricing method. As a result, substantially less new generating capacity would be required than is currently forecast."

Levy adds that the arguments advanced in favor of incremental-cost pricing apply to the entire electric-utility industry, and not simply to the Pacific Northwest market. "To various degrees, the wide-spread use of average-cost pricing methods is holding electric-utility rates everywhere below those that would prevail under long-run incremental-cost pricing, spurring the growth of electrical consumption and causing too many resources to be devoted to power generation."